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Is Social Impact Investing The Next Venture Capital?

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In late August, mobile security company Lookout raised $150 million in venture capital, taking advantage of the surging demand for cybersecurity products that had already attracted nearly $900 million in VC funding in the first half of the year.

Why can't we address social needs with similar inventiveness and resources?

Poverty, homelessness, crime, unemployment continue to plague even the wealthiest of nations. Imagine if in addition to existing efforts, we could leverage trillions in private capital and bring the same level of focus and entrepreneurial dynamism that we see in the private sector to meet the pressing needs for better schools, more job opportunities, improved public services, safer streets?

We don't have to imagine. It is already happening – and it is called impact investing. The idea is simple enough – to invest in efforts that not only provide a return on investment, but also target specific social needs.

We can dramatically accelerate the growth of this important market by partnering with government to remove roadblocks.

If you don't think government policies matter in the development of new investing opportunities, think about how the venture capital market emerged.

Started in the mid-1960s, the idea of professionally-managed venture capital partnerships had nearly evaporated by late 1970s. That's when the U.S. government implemented several changes that sparked the growth of a successful industry.

Among the policy changes were clarifications to ERISA's "Prudent Man" rule that allowed pension funds to make VC investments, and a safe harbor rule making it clear that VC managers wouldn't be considered plan fiduciaries.

In just two years, VC investments went from virtually zero to more than $5 billion. And this capital helped unleash waves of innovation.

Now we are poised to see the same happen with impact investing.

And around the world, there are stories of how impact investments are meeting needs in areas as diverse as childhood education, clean technology, and financial services for the poor.

Last year, New York State, Social Finance and Bank of America Merrill Lynch teamed up to launch a "social impact bond" designed to cut New York City's seemingly insoluble recidivism problem. The $13.5 million raised will extend the proven approach of the Center for Employment Opportunities. If the Center meets targets for reducing recidivism rates, investors stand to earn up to a 12.5% return.

Or take d.light – a company that manufactures and distributes solar lighting and power products to those without access to reliable electricity, transforming lives in the developing world. Over eight years, d.light has reached more than 30 million people worldwide.

Recently, J.P. Morgan and the Global Impact Investing Network studied 125 major fund managers, foundations, and development finance institutions and found $46 billion in sustainable investments under management. That's up nearly 20% from last year.

Some estimate that the impact investment market could grow to $3 trillion. And as the more socially conscious millennial generation of entrepreneurs build impact-driven businesses, you can be sure the supply of impact investment opportunities will vastly expand.

This week, a new comprehensive report released by the Social Impact Investment Taskforce established under the UK's presidency of the G8 outlines comprehensive policy steps that should be taken to realize the potential. Among them: regulators should once again review ERISA rules for pension funds to make it clear that plan managers can consider social, targeted economic, or environmental factors in investment decisions because they affect the long-term financial performance of their investments.

The IRS, too, should refine its rules about foundation investments in for-profit enterprises to help fill the funding gap between grants and commercial capital. Government agencies need more flexibility to engage in pay-for-success commissioning and experiment with new approaches to old problems.

When the venture capital market exploded in the 1980s, it changed the face of entrepreneurship, the global economy, and our society for the better. New products and services flooded the market. Fierce competition drove affordability and quality up.

Impact investing is poised to change the trajectory of poverty, crime, homelessness, for education, green energy and much more. It just needs to be unleashed.

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